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ABSTRACT

This report describes principles and techniques for credit management. Topics covered include: (1) methods of determining personal credit limits; (2) ways to keep track of credit use; (3) suggestions for planning credit use; (4) explanations of single-payment charge accounts, revolving credit, installment credit, and consolidation loans; and (5) techniques for building and maintaining self-discipline in using credit. Information in this report is current at the time of printing, October 1980, but is subject to change. (DC)

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Managing Your Credit

Credit can be one of your most valuable assets or your biggest downfall—it all depends on how you manage it. This report describes some credit management principles and techniques that can help you deal effectively with our "buy now, pay later" society.

YOUR CREDIT PICTURE When your wallet is nearly empty or your checkbook balance is low, you know that you're nearing your spending limit. But if you use credit, you can overspend without realizing it—until the bills come in. That's why wise credit use requires planning and monitoring.

Take a look at your current credit situation. Do you know how much you pay out each month on credit obligations and whether or not your debt is in line with your income? If your credit picture isn't clear, perhaps you need to organize your records and take a closer look.

Experts' Yardsticks How do you know when it's time to stop buying on credit? There's no single answer to this question because it depends on your individual circumstances, such as the size and stability of your income and your present and anticipated expenses.

One guideline is whether the percentage of your income that goes to repay loans is higher than the limits used by creditors to evaluate loan requests. Although this varies, lenders generally agree that a "safe" percentage would be to spend no more than 30% to 40% of your gross income on housing expenses (mortgage or rent, property taxes, and insurance) and instalment debts. To figure what you're spending, divide the total of your monthly housing and instalment payments by your monthly gross income.

Another rule of thumb often used by financial counselors is that you should stop charging whenever your credit payments (not including a mortgage) approach 15% to 20% of your take-home pay (what's left after income taxes, Social Security, and any other deductions). Test yourself against this guideline by dividing the total of your monthly loan payments by your monthly take-home pay.

Again, remember to take your individual circumstances into account. For example, a family of four whose monthly take-home pay is \$900 probably will have more difficulty handling a 15% debt load (which leaves \$765 a month for all other living expenses) than a family of four whose take-home pay is \$1,500 (leaving \$1,275 a month for other expenses).



Another way to size up your credit picture is to take an honest look at your money management habits.

Danger Signals The following are clear danger signals that mean you're getting overextended. Any one of these signals can indicate trouble is brewing; but several together are cause for real concern.

- Juggling payments—stalling one creditor to pay another.
- Receiving past-due notices in credit billing statements.
- Failing to save even a little money each month.
- Charging more each month than you make in payments on your accounts.
- Taking longer and longer to pay off credit account balances.
- Running out of money before payday.
- Using credit card cash advances to cover everyday living expenses or to make payments on other credit card accounts.

A sharply focused credit picture will show the trouble spots that need your attention. Or, if the picture looks good, you'll want to be sure it stays that way. In either case, the following techniques can help you become a more skillful credit manager.

YOUR PERSONAL CREDIT LIMIT

There's a limit to the amount of credit you can get on any one of your credit accounts; but, if you have many accounts, the total limit available to you may be more than you can handle. So, it's really up to you to establish your own "personal credit limit"; that is, the most you'll allow yourself to carry on all of your accounts—including instalment loans as well as credit cards and charge accounts—at any given time.

Perhaps the most workable way to find your personal credit limit is to figure out how much you can afford to pay each month for credit purchases. This may mean setting up a budget if you don't already have one. (For help, see Report #14 in this series, *Personal Money Planner*.) Or, at least, you'll need to evaluate your monthly cash flow—money you receive and pay out. Though your focus is on the total of your monthly credit payments, don't overlook the amount of your total debt outstanding. The higher it goes, the more you have to pay each month to meet your obligations.

Once you establish your personal credit limit, you must plan your credit spending so that the total of all your monthly credit payments does not exceed this amount.

For example, suppose you set your personal credit limit at \$180. If your car payment is \$100 a month, you pay \$20 a month on your bank card, and you normally charge \$40 a month on your oil company card (which you probably pay in full each month), then you have a leeway of \$20. You can apply that money to an existing debt—your bank card, for instance—so you can pay it off sooner and save on finance charges. Or, you can put the extra money in savings, spend it, or take on additional debt.

Reevaluate your credit limit from time to time. Don't be too quick to increase it unless you honestly believe you can handle the additional debt—perhaps because of a raise in pay or other change in your financial status.

KEEPING TRACK To make sure you stay within your personal credit limit, you'll need to keep track of your charge account and credit card purchases. This is fairly simple if you have only one or two accounts; but if

to maintain a number of accounts, you may lose sight of your overall credit picture.

Credit Register You can set up a credit register, like the one shown on this page, to use as a tool in your personal credit management. It works much like your regular checkbook register, except that you add credit purchases and finance charges to the balance and subtract monthly payments from it. (In the illustration, monthly payments are circled to distinguish them from purchases and to indicate that they are subtracted from the balance.) The balance represents money you owe rather than money available to spend.

It's important to enter purchases and payments as you make them so that your credit register always reflects your current credit standing. Also, keep your credit register and your other financial records—such as your budget and instalment loan records—in one place for quick reference when you want to review your overall credit picture.

Alternatives If you prefer to keep less detailed records, you can modify the credit register. Rather than noting individual purchases as you make them, tally your charge slips each week and enter the totals for each account.

You may be able to keep track of your credit spending by simply reviewing your monthly statements or by regularly reviewing your charge slips. But bear in mind that the more closely you track your credit spending, the clearer your credit picture will be.

PLANNING CREDIT USE Knowledgeable business managers plan for credit use. They look ahead to see when credit may be needed to finance business activities. Then they consider which kinds of credit will be available and select the kind that best suits the situation. You can use the same technique in managing your personal use of credit.

First, consider what major expenses you're likely to have in the next six months to a year. Then, determine whether you'll be able to meet the expenses from your regular income and anticipated savings during that period. If you think you may have to borrow, consider the various types of credit available to you. Planning this way provides the opportunity to shop carefully, both for the credit arrangement and the purchases you want to finance.

Since many types of credit are available, it can be a challenge to select the type most suitable for a particular purpose. Here are some guidelines that may help you.

CHARGE ACCOUNTS It's important to know which of your credit cards and charge accounts are single-payment credit accounts and which are revolving credit

BankAmericard VISA (\$500 limit)			
Date	Item	Amount	Bal. Fwd.
			\$100.00
5/5	Shoes	\$ 37.10	137.10
5/12	Bicycle	159.00	296.10
5/20	Finance Chg.	2.51	298.61
6/2	Payment	175.00	123.61
6/9	Shirt	15.45	139.06

accounts. The type affects the cost and the repayment requirements.

Single-Payment With this type of credit, you must pay your bill in full each month. Most travel and entertainment cards, for example, are designed this way. You usually are not assessed a finance charge, so long as you pay on time. However, if you don't keep a close watch on your use of this type of credit, you may end up with bills that will throw off your entire budget. (Your credit register will help you keep track.)

Revolving Credit Bank cards and retail credit cards commonly work on a revolving credit basis. Within a specified limit you may charge purchases and, with some bank cards, you can also get cash advances.

The minimum payment you must make each month is based on your outstanding balance; of course, you can pay more than the minimum amount. Depending on the policy of the creditor, you may not be charged interest if you pay the account in full within a specified time—generally 25 to 30 days from the date of your statement.

Interest rates for revolving credit are higher than for some other forms of credit; also, the longer you take to repay, the more dollars you'll spend on interest.

INSTALMENT CREDIT Instalment credit—credit you pay back in regular intervals over a fixed period of time—is available directly from lending institutions and is usually granted for a single, specific purpose, such as buying a car or taking a vacation. You may also be able to get instalment credit through the seller of a product you're buying—from an auto dealer to finance a car, for instance. You must apply for instalment credit each time you want to use it and, depending on what you're financing, you may have to make a down payment. Interest rates for instalment credit are often lower than on revolving credit, especially if you pledge property such as a car or a savings account as collateral for repayment of the debt. However, it's to your advantage

to shop for instalment credit because annual percentage rates, other credit costs, and repayment terms vary widely.

CONSOLIDATION LOANS A consolidation loan is an instalment loan designed to pay off a number of debts and is usually obtained because these debts are threatening to become unmanageable. The monthly payment on a consolidation loan generally will be less than the amount you paid on the bills you consolidated. This is because you'll be extending your payments over a longer period.

A consolidation loan can have the advantage of protecting your credit history by paying the bills before they become delinquent. However, it can also have disadvantages. The main drawback is the cost. Because the loan usually has a higher interest rate and longer repayment term than the debts that are consolidated, you'll probably pay considerably more in finance charges. And, you may be required to provide collateral that has a value equal to or greater than the amount you're borrowing.

Another drawback is that the reduction in monthly payments might lead you to think you have extra money, tempting you to take on more credit obligations. This can cause even more serious financial problems.

CREDIT DISCIPLINE To help you build and maintain the self-discipline you need to keep your credit picture in good order, consider some of the following tactics.

- Cut down on the number of retail charge accounts and credit cards you have. This will limit your potential credit "liability."
- Make it a practice to postpone a credit purchase until you've thought it over for a few days—unless it's for an emergency.
- Borrow only the amount you need and make as large a down payment as you can. If you're using a credit card or charge account, you may want to pay for a portion of the purchase in cash.
- Protect your credit record. Make payments on time and for the full amount you agreed to. If you can't pay because of financial difficulties, take the initiative and contact your creditors to explain the problem.
- Seek financial counseling if you need it because of excessive debt. You can get help from Consumer Credit Counselors, a nonprofit community organization with offices located in major California communities. Counselors offer free advice and will, for a fee based on your ability to pay, administer a repayment plan which they design in cooperation with your creditors.
- Combine your credit use with a savings plan. After you pay off a revolving or instalment debt, put the amount of that monthly payment into a savings account.

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